4 FAM 730
INVENTORY AND PROPERTY, PLANT, AND EQUIPMENT

(CT:FIN-384;   06-19-2007)
(Office of Origin: RM/FPRA/FPMC)

4 FAM 731 PURPOSE AND AUTHORITY

4 FAM 731.1 Purpose

(CT:FIN-384;   06-19-2007)

This subchapter provides the financial management policies for accounting and reporting on Department of State inventory and property. It covers the basic requirements for designating inventory, operating materials, personal and intangible property as well as the costs that must be accumulated and reported for each designation.

4 FAM 731.2 Authority

(CT:FIN-384;   06-19-2007)

a. 31 U.S.C. 3512(b) provides that each executive agency shall establish and maintain systems of accounting and internal controls that provide effective control over, and accountability for, assets for which the agency is responsible.

b. Other legislation that impacts the provisions in this subchapter include:

   (1) Chief Financial Officers Act (CFO), 31 U.S.C. 901 - 903;

   (2) Federal Manager’s Financial Integrity Act (FMFIA), Public Law 97-255 (1982);

   (3) Federal Financial Management Improvement Act (FFMIA), Public Law 104-208, sec. 801 et seq. (1996); and

   (4) The Information Technology Management Reform Act of 1996 (Clinger-Cohen Act), sec. 5126, 40 U.S.C. 11316.

c. Other relevant regulations and guidance include:

   (1) OMB Circular A-123, Management Responsibility for Internal Controls;

   (2) OMB Circular A-126, Improving the Management and Use of

Government Aircraft;

(3) OMB Circular A-134, Financial Accounting Principles and Standards; and

(4) Federal Management Regulations, 41 CFR Part 102-33 (Management of Aircraft).

d. Statement of Federal Financial Accounting Standards (SFFAS) - OMB Circular A-134 provides that “SFFASs shall be considered generally accepted accounting principles (GAAP) for Federal agencies. Agencies shall apply the SFFASs in preparing financial statements in accordance with the requirements of the Chief Financial Officers Act of 1990.”

4 FAM 732 INVENTORY AND OPERATING MATERIALS

(CT:FIN-384; 06-19-2007)

a. Inventory is tangible personal property that is:

(1) Held for sale;

(2) In the process of production for sale; or

(3) To be consumed in the production of goods for sale or in the provision of services.

b. Operating materials and supplies consist of tangible personal property to be consumed in normal operations. Specific items excluded from operating materials are:

(1) Goods that have been acquired for use in the construction of real property or in assembling equipment to be used by the entity;

(2) Stockpiled materials;

(3) Goods held under price stabilization programs;

(4) Foreclosed property;

(5) Seized and forfeited property; and

(6) Inventory.

c. Additional information is found in the Statement of Federal Financial Accounting Standards (SFFAS) Number 3.

4 FAM 732.1 Accounting for Inventory

(CT:FIN-384; 06-19-2007)

The Department has inventory items for sale at domestic facilities and facilities abroad under the Working Capital Fund as well as publications held for sale at the regional printing offices abroad. The inventory values, namely furniture, publications and raw materials used in the production of publications, are recorded in the Department's general ledger. The inventories are valued in accordance with accepted valuation methods (e.g., weighted moving average for the Washington Logistics Center and stock account and the cost of production for publications held for sale) and adjusted for the results of periodic physical inventories.

4 FAM 732.2 Accounting for Operating Materials

(CT:FIN-384; 06-19-2007)

a. Statement of Federal Financial Accounting Standards (SFFAS) Number 3 permits individual agencies to use the purchase method (instead of the consumption method) of accounting for the recognition of expenses of operating materials and supplies if:

   (1) The materials and supplies are not significant amounts;

   (2) The materials and supplies are not in the hands of the end user; or

   (3) It is not cost beneficial to apply the consumption method.

b. In accordance with these principles, the Department has determined that the purchase method is the appropriate method for treating all operating materials. All operating materials and supplies should be expensed when purchased.

4 FAM 733 PROPERTY, PLANT AND EQUIPMENT (PP&E) GENERAL PROVISIONS

(CT:FIN-384; 06-19-2007)

a. Under the Federal Financial Management Improvement Act of 1996, the Department is required to implement financial management systems that comply with Federal accounting standards, which include the Statements of Federal Financial Accounting Standards (SFFAS) governing property, plant, and equipment. The accounting standards for property are provided in SFFAS Numbers 6, 8, 10, 11, 14, 16, and 23.

b. Sections 4 FAM 733.1 through 4 FAM 736.3 contain the Department of State's accounting policy pertaining to the accounting for personal property. Policies and procedures for personal property management in accordance with applicable General Services Administration and other regulations may be found in 14 FAH-1, Department-Wide Personal Property Management Handbook.

c. Property, plant and equipment are assets that are acquired by procurement, transfer, capital lease, donation or other method that transfers ownership and have the following characteristics:

(1) A useful life of two or more years;

(2) Not intended for sale; and

(3) Intended to be used to conduct business.

d. Assets that are classified as personal property shall be accounted for in accordance with the designations identified in 4 FAM 733.1.

4 FAM 733.1 Property, Plant and Equipment (PP&E) Designations and Classifications for Personal Property

(CT:FIN-384; 06-19-2007)

The Statement of Federal Financial Accounting Standards (SFFAS) Number 6 as amended by subsequent standards requires personal property to be designated as either:

(1) General; or

(2) Heritage.

4 FAM 733.1-1 General Property, Plant and Equipment (PP&E)

(CT:FIN-384; 06-19-2007)

a. General property, plant and equipment (PP&E) consists of items that are used:

(1) To produce goods or services or to support the mission of the entity and can be used for alternative purposes (e.g., by other Federal programs, State and local governments, or nongovernmental entities);

(2) In business-type activities; or

(3) By U.S. Government entities in activities whose costs can be compared to other entities.

b. Most personal property in use in the Department is general PP&E. Unless the personal property meets the specific definition for heritage assets, the property is designated as general purpose and recorded at acquisition cost in the appropriate general ledger account if it equals or exceeds the capitalization threshold for the asset type. The cost recorded will be consistent with the cost requirements for property accountability (see 14 FAH-1 H-415.2) and the capitalized cost requirements in 4 FAM 734 and 4

FAM 735. Indirect costs will be added to the capitalized cost basis when 4 FAM 734.1 is applicable. Examples of general PP&E include vehicles, communications equipment, reproduction equipment, medical equipment, information technology (IT) hardware, aircraft, and software.

c. Except for software, software-in-development, and property located in high-risk areas, personal property is depreciated (straight-line method) in accordance with the estimated useful life of the property. Software is amortized in accordance with the capitalization policy in 4 FAM 735.1, the capitalization thresholds identified in 4 FAM 734.2, subparagraph a(4), and the amortization policy in 4 FAM 734.3, subparagraph (3). The high-risk property depreciation convention is identified at 4 FAM 736.3.

4 FAM 733.1-2 Special Rules for Some Categories of General Property, Plant and Equipment (PP&E)

(CT:FIN-384; 06-19-2007)

a. Internal use software is generally classified as general property under Statement of Federal Financial Accounting Standards (SFFAS) Number 6. However, internal use software has special accounting requirements that must be followed under the SFFAS Number 10 - Internal Use Software for software designed for internal use and acquired after October 1, 2001. All Department software is classified as intangible general property even if it is used to support property with a different designation (e.g., heritage). The accounting treatment for internal use software is identified at 4 FAM 735.

b. Software developed to perform functions for internal business needs, is recorded as a separate intangible asset in the Department's general ledger. However, when the software in personal property is not separately identified by the manufacturer at the time of procurement, it does not have to be separately capitalized in the Department's general ledger. If the personal property requires a future software upgrade that meets the criteria in 4 FAM 735, the software upgrade cost should be considered an integral part of the general property, plant and equipment (PP&E) and must be identified and recorded. The aggregate cost of upgraded software should be used to determine whether to capitalize or expense the cost.

c. U.S. Government-owned property in the hands of Department contractors is general PP&E and must be identified and reported on Department financial statements in a manner consistent with the requirements of this subchapter (see 4 FAM 736). U.S. Government-leased property provided to contractors shall not be identified or recorded in the general ledger as U.S. Government-owned. Special property accounting rules are applied to contractor-held assets maintained in a hostile program environment (see 4 FAM 736.3).

d. Aircraft assets managed by the Bureau of International Narcotics and Law Enforcement Affairs (INL) are general PP&E and subject to provisions in SFFAS Number 6 as well as OMB Circular A-126 and the Federal Management Regulations, Title 41, Part 102-33, Management of Aircraft. There are special rules related to accounting for aircraft assets contained in 4 FAM 736.2-1. Fixed-wing, rotary aircraft and component spare property for aviation operations shall be associated with a separate asset class (see 4 FAM 733.1-3, paragraph b).

4 FAM 733.1-3 General Personal Property, Plant and Equipment (PP&E) Classifications

(CT:FIN-384; 06-19-2007)

a. For general property, separate general ledger accounts shall be used for significant classifications of personal property. Common classifications shall be used for both accounting and property management purposes. The classification also identifies types of property for which value must be regularly reported to the Congress or other executive agencies.

b. The financial management system classifies personal property according to the following categories:

(1) Vehicles (see paragraph c of this section);

(2) Communications Equipment;

(3) Information Technology (formerly called Automated Data Processing) Equipment;

(4) Reproduction Equipment;

(5) Security Equipment;

(6) Software;

(7) Software-in-Development;

(8) Medical Equipment;

(9) Aircraft Property; and

(10) Other Depreciable Personal Property.

c. The classification of property as vehicles shall be in accordance with Office of Logistics Management (A/LM) guidance. Property acquisitions for all human-powered or nonmotorized transportation property such as bicycles, tricycles, scooters, wagons, trailers, etc., are not to be classified as vehicles. These property items should be classified as "other" personal property and subject to the applicable personal property capitalization threshold, when warranted. Salvage values for motor vehicles will be

10% except for vehicles subject to Bureau of Diplomatic Security (DS) disposal guidance in 12 FAM 388 (armored vehicles) or contractor-held vehicles in high-risk areas, which will have zero salvage value in accordance with 4 FAM 736.3. Commercially leased and GSA Fleet-leased vehicles shall not be identified as U.S. Government-owned property in the financial management system.

4 FAM 733.2 Heritage Property

(CT:FIN-384; 06-19-2007)

a. To be characterized as heritage property, plant and equipment (PP&E), an item should have:

   (1) Historical or natural significance;

   (2) Cultural, educational or artistic importance; or

   (3) Significant architectural characteristics.

b. The acquisition cost for heritage properties is not capitalized unless the property is a multi-use heritage asset, which is subject to specific requirements for financial statement presentation in 4 FAM 733.2-2.

4 FAM 733.2-1 Heritage Personal Property Classifications

(CT:FIN-384; 06-19-2007)

a. Personal property that may be classified as heritage includes rare books for permanent collections, gift fund items (e.g., antique furniture, rare documents, etc.), and art items identified as works of art in the Department's collections. Heritage personal property is not recorded in the financial management system general ledger as an asset and cost information is disclosed in the financial statements in accordance with 4 FAM 733.2-3. However, property accountability records must be maintained and the assets should be valued for insurance purposes.

b. Except as provided in 4 FAM 733.2-2, the acquisition cost of a heritage asset shall be recognized as an expense in the period incurred and is not capitalized. Except as provided in 4 FAM 733.2-2, the cost of improving, reconstructing, or renovating a heritage asset shall be recognized as an expense in the period incurred and is not capitalized. If a heritage asset is transferred from another Federal entity, the cost shall be the book value of the asset recorded on the transferring entity's books and shall be recognized as an expense in the period transferred. There is no cost recognized in the general ledger or for financial reporting for heritage assets acquired through donation or devise.

c. Procedures for recording personal property heritage assets in Department financial management systems may vary by oversight organization and type of asset being managed. Questions regarding recording requirements and specific procedures to follow should be addressed to the Bureau of Resource Management's Financial Policy Reporting and Analysis Directorate (RM/DCFO/FPRA).

4 FAM 733.2-2 Multi-Use Heritage Asset Costs

(CT:FIN-384; 06-19-2007)

a. Heritage property may have dual functions—a heritage function and a general U.S. Government operations function. A heritage asset is considered a "multi-use" heritage asset if its predominant use is general U.S. Government operations. A heritage asset having only an incidental use in U.S. Government operations is designated as a heritage asset.

b. If the heritage asset is a multi–use heritage asset, the accounting procedures for general property apply. The costs of acquisition and/or refurbishment of multi-use heritage assets are expensed or capitalized in accordance with cost thresholds associated with general property, plant and equipment (PP&E). Depreciation of these capitalized costs will be consistent with depreciation conventions for general PP&E and disclosed as part of general PP&E costs.

4 FAM 733.2-3 Disclosure of Heritage Assets

(CT:FIN-384; 06-19-2007)

Heritage assets are disclosed in the required supplementary information (RSI) section of the financial statements. The heritage assets disclosed include personal property, collections, rare books and manuscripts, and any other items in the Department's historical collections. Disclosure is presented in aggregate totals and must include a description, count of acquisitions and withdrawals, condition, number of items, and status of deferred maintenance. In addition, Statement of Federal Financial Accounting Standards (SFFAS) Number 29 requires the disclosure of entity stewardship policies and how heritage property relates to the mission of the Department. There is no depreciation expense associated with these assets unless they are multi-use heritage assets.

4 FAM 733.3 Property Records and Systems

(CT:FIN-384; 06-19-2007)

a. The financial management system must accurately reflect the acquisition cost of capitalized personal property in various categories and the accumulated depreciation/amortization (see 4 FAM 733.1-1 and 4 FAM 734.3). Procurement, property record maintenance, and related accounting operations shall be integrated so that entries to the subsidiary property records and control accounts are accomplished essentially from the same document, thus creating a single set of records for property.

b. The Department uses a fixed asset module in the official financial management system to record property costs in the general ledger accounts. The information in this module is supported by property management systems managed by other organizations, such as the Integrated Logistics Management System. These property management systems must therefore contain common data elements and standardized formats compatible with the financial management system.

4 FAM 733.4 Reconciliation of Financial Accounting Records to Property Accountability Records

(CT:FIN-384; 06-19-2007)

a. The responsible property officers in bureaus and posts shall conduct physical counts of property, plant and equipment (PP&E) personal property at regular intervals as specified in regulations in 14 FAM 410 and 14 FAM 420. All property holding, including the capitalized property from this physical inventory procedure shall be reported to the Office of Logistics Management (A/LM). The schedules and procedures for taking such counts are established in 14 FAH-1 H-600.

b. Inventory procedures and accounting record adjustments shall be applied on a consistent basis from one fiscal year to another. All U.S. Government-owned capitalized personal property, including Bureau of International Narcotics and Law Enforcement Affairs (INL) aviation assets and U.S. Government-owned property held by contractors, will be reconciled to the records used for tracking such property. U.S. Government-leased property is not part of this reconciliation since leased property in not recorded in the financial management system general ledgers. Adjustments will be made in the official financial management system based on the reconciled information recorded in the property management systems.

4 FAM 733.5 Accounting Classification and Conveyance Requirements

(CT:FIN-384; 06-19-2007)

a. **Disposition of property**: Property accounts must be adjusted for both acquisition cost and depreciation values of retirements, losses, or other means of property disposal, including property destroyed or demolished. Removal costs and amounts realized shall be considered in determining the loss or gain on the disposition of property. Gains and losses on disposal of assets are recognized separately in the accounts.

b. **Trade-ins**: The cost recorded for property acquired as a result of trade-ins with a private vendor or another Federal entity shall be the lesser of:

   (1) The cash paid or payable, plus the amount allowed by the seller on the trade-in property; or

   (2) The purchase price of the property acquired if there had been no trade-in.

   Gains or losses realized on trade-ins are recorded in separate accounts. The amount of gain or loss is the difference between the value of the property received and the value of any materials and services exchanged.

c. **Reimbursable transfers**: Property transferred to the Department's custody on a reimbursable basis from other Federal agencies shall be accounted for on the basis of the transfer price as determined by agreement or application of appropriate statutory requirements or regulations, but at not less than its estimated fair value.

d. **Transfers from other Federal entities**: The cost of the property transferred without reimbursement from other Federal agencies shall be the cost recorded by the transferring entity less the accumulated depreciation or amortization. If these amounts cannot be determined, the cost of the property shall be its fair value at the time transferred.

e. **Donations, devise, judicial process**: The cost of general personal property acquired through donations, devise (bequest) or judicial process (excluding forfeiture) shall be the estimated fair value of the property at the time acquired by the Department.

f. **Forfeiture**: The cost of property acquired through forfeiture shall be determined in accordance with the specific property accounting treatment described in Statement of Federal Financial Accounting Standards (SFFAS) Number 3.

g. **Exchange**: The cost of property acquired through exchange with a non-Federal entity shall be the fair value of the property surrendered at the time of the exchange. If the fair value of the property acquired is more readily determinable than that of the property surrendered, the cost shall be the fair value of the property acquired. If neither fair value is determinable, the cost shall be the cost of the property surrendered (less any accumulated depreciation or amortization). Any difference between the net book value of the property surrendered and the cost of the property acquired shall be recognized as a gain or loss. If cash consideration is included in the exchange, the cost of the property acquired shall be increased by the amount of the cash paid or decreased by the amount of the cash received.

4 FAM 733.6 Responsibility for Property, Plant and Equipment (PP&E) Accounting

(CT:FIN-384; 06-19-2007)

a. Various organizations share responsibilities for accounting for property with the Bureau of Resource Management (RM). RM maintains the property subsidiary ledgers for financial reporting within the financial management system and is responsible for providing guidance to other bureaus concerning the accounting policies and procedures for property.

b. The Department organization responsible for the acquisition, improvement, repair or refurbishment of property shall record the property in a Department-approved property management system (e.g., Integrated Logistics Management System (ILMS)). If there is property maintained in systems that do not have automated interfaces with the financial management property subsidiary, the responsible organization must establish a process with RM to record the acquisition, disposal and cost information in the financial management system subsidiary property ledgers. The responsible organization must ensure timely and accurate reporting in its property management system for all property acquisitions, transfers and disposals.

c. Responsibilities for tracking software development costs are described in 4 FAM 733.7.

d. For U.S. Government-owned property held by contractors, the contracting officer representative or designee from the responsible organizations is responsible for tracking and recording the property as described in 4 FAM 736.1. U.S. Government-leased property held by contractors may be tracked for accountability purposes consistent with Office of Logistics Management (A/LM) guidance but such property is not reflected in the general ledgers of the financial management system. Definitions and supplemental information for property held by contractors may be found in Federal Acquisition Regulation (FAR) Part 45 Government Property.

4 FAM 733.7 Responsibility for Tracking Software Development Costs

(CT:FIN-384; 06-19-2007)

a. Program offices responsible for the development or procurement of software must follow Bureau of Resource Management (RM) requirements to track and capture costs for software investments. RM must maintain software in development and finished software subsidiary ledgers to meet reporting requirements under Statement of Federal Financial Accounting Standards (SFFAS) Number 10. Therefore, any organization undertaking a software development initiative must establish a project-based process that identifies an initiation and termination/completion of software development investments (see 5 FAM 600 for required project processes).

b. If software meeting the definitions and conditions identified in 4 FAM 735 is procured as part of a larger initiative, the software cost must be a sufficiently identifiable item within the procurement activity to be accounted for separately as software.

c. The responsible organization shall inform RM and the eGov Project Management Office of the initiation and completion/termination of each software project as well as the expected date the software property will be placed in service. This includes the termination of projects prior to completion. Department policy also requires software to be registered in the Information Technology Application Baseline and vetted through the Information Technology Change Control Board (IT CCB) or local Change Control Board (CCB) process before submission to Information Assurance in the Bureau of Information Resource Management (IRM/IA) for system authorization review.

4 FAM 734 ACCOUNTING FOR COST OF PERSONAL PROPERTY

(CT:FIN-384; 06-19-2007)

a. Personal property whose initial acquisition cost exceeds the applicable capitalization threshold (see 4 FAM 733.1-1 and 4 FAM 734.2) must be recorded in the accounts at the cost of bringing the property to a state of usefulness, including transportation to the point of initial use, installation, net of purchase discounts (whether or not taken), and other related costs. When justified for a particular situation, standard or average costing associated with groupings of property is permissible provided that information as to location and use of each item is maintained.

b. Capitalized costs for motor vehicles include not only the initial acquisition cost but also delivery charges associated with the vehicle, shipping costs to posts abroad, and other preparation costs (e.g., light/heavy armoring, etc.) needed to ready the vehicle for its intended function. Commercially leased or GSA fleet-leased vehicles are not individually capitalized in the financial management system general ledger (see 4 FAM 734.2, paragraph b, for personal property capital leases).

c. For capitalized general purpose property transported in bulk via containerized shipments, transportation and related costs shall be recorded as follows:

(1) When the costs can be readily determined for each item

(transportation and related costs), pre-delivery costs shall be distributed and posted to the property records and general ledger accounts;

(2) When the costs cannot be readily determined for each item (transportation and related costs), pre-delivery costs shall be charged as current operating expenses.

4 FAM 734.1 Indirect and Overhead Costs for Property

(CT:FIN-384; 06-19-2007)

a. In addition to capturing the direct costs described in section 4 FAM 735.3, paragraph c, the responsible organization shall identify for capitalization purposes the indirect overhead costs associated with software property. Indirect overhead costs for software property shall include the following components to the extent that they can be reasonably and consistently allocated to the software property in accordance with subparagraph (1)(b) of this section:

(1) Oversight organization salary and benefit costs and/or contractor costs for:

(a) Supervisory personnel overseeing staff responsible for multiple software projects;

(b) Personnel retained as experts in software design tools;

(c) Personnel supporting software development/acquisition; and

(d) Office space for direct-hire personnel and/or U.S. Government-furnished space and equipment for contractor personnel;

(2) Travel and fixed facility (office space, utilities, supplies, computer hardware, etc.) costs for organization supervisory and other personnel (legal, procurement, financial, administrative, etc.) responsible for supporting software development;

(3) Fees, licenses and/or other costs for software development activities but are not directly attributed to specific projects.

b. Indirect costs for software may be calculated as a percentage of direct costs if historical data shows a consistent relationship between direct costs and indirect costs. This standard percentage is the preferred method to determine the indirect costs of a project. However, when this method is not appropriate, the Bureau of Resource Management's Office of Financial Policy and Management Controls (RM/FPRA/FPMC) should be contacted for guidance on alternative methods for applying indirect costs under Statement of Federal Financial Accounting Standards (SFFAS) Number 4.

c. Indirect and overhead costs for general personal property do not have to be identified when it is not cost effective to do so and the costs do not have a material impact on the cost basis of the capitalized property.

4 FAM 734.2 Capitalization Criteria for Personal Property

(CT:FIN-384; 06-19-2007)

a. **Personal property**: Personal property classified as fixed assets shall be capitalized or accounted for as follows:

(1) Except for property described in subparagraphs a(2), a(3), and a(4) of this section, personal property shall be capitalized at the date of acquisition if:

(a) It is complete within itself;

(b) It does not lose its identity or become a component part of other property when put into use;

(c) Its value exceeds $25,000 on the date of acquisition; and

(d) It is of a durable nature with an estimated useful life expectancy to exceed two years;

(2) Personal property capital leases do not have a threshold. These leases must be recorded at the computed value of the lease terms required by 4 FAM 734.2, paragraph b;

(3) All motor vehicles, including U.S. Government-owned vehicles held by contractors in high- risk locations, do not have a capitalization threshold. All classes of motor vehicles (e.g., sedans, passenger vehicles, trucks, utility vehicles, vans, etc.) shall be fully capitalized regardless of acquisition cost. U.S. Government-furnished commercially leased and GSA fleet-leased vehicles provided to contractors are not capitalized even though contractors will be required to identify such vehicles when providing a list of all contractor-held property;

(4) Software capitalization thresholds: Most internal-use software as defined in 4 FAM 735 shall be capitalized if its total cost is equal to or exceeds $500,000. This means that the procurement options for Commercial Off the Shelf (COTS), Government Off the Shelf (GOTS), or mixed use software as described in 4 FAM 735.3, paragraph e, shall be capitalized if its total cost (e.g., purchase, configure, test, etc.) is equal to or exceeds $500,000. Individual

COTS/GOTS software packages or site licenses that equal or exceed $25,000 in cost and that are acquired as part of a deployment initiative are considered an element of personal property and should be capitalized in accordance with procedures for personal property (see 4 FAM 734.2, subparagraph a(1)). Software that is a component of another piece of personal property is subject to the special rules in 4 FAM 733.1-2.

b. **Personal property capital leases**: Leases meeting one or more of the following criteria shall be classified as capital leases:

(1) Lease transfers ownership to the U.S. Government at the end of the lease term (i.e., fixed noncancelable term);

(2) Lease contains an option, to purchase the property at a bargain price;

(3) Lease term is equal to 75% or more of the estimated economic life of the leased property;

(4) Present value at the beginning of the lease of the minimum lease payments is 90% or more of the fair value of the leased property.

NOTE: Capital leases shall be recorded as an asset and a liability at an amount equal to the net present value at the beginning of the lease of the minimum lease payments during the lease term, excluding costs to be paid by the lessor (taxes, insurance, etc.). However, if the amount so determined exceeds the fair value of the property, the fair value should be recorded.

c. **Purchases**: Purchases made under lease/purchase contracts which are in fact purchases (the decision to purchase having already been made) are treated for capitalization purposes as installment purchases.

4 FAM 734.3 Depreciation and Amortization Conventions for Personal Property and Software

(CT:FIN-384; 06-19-2007)

The following information provides general guidance on the depreciation and amortization conventions for property, plant and equipment (PP&E). Depreciation conventions are applied to personal property that has been constructed, purchased, transferred, or exchanged. Amortization conventions are applied to personal property leases and internal use software:

(1) **Basic principles**: In accordance with Statement of Federal Financial Accounting Standards (SFFAS) Number 6, the accounting system recognizes and records depreciation and amortization on all capitalized general purpose and mixed-use property. Depreciation

begins when the property is placed in service. Depreciation and amortization charges shall be recorded down to the functional element level and at the organizational level in the Department and the suborganizational level at posts. Except for the software impairment provision in 4 FAM 735.6, obsolescence is recognized in the useful life established for determining depreciation;

(2) **Personal property depreciation rates**: Depreciation rates are established on a straight-line basis for the estimated useful life of respective depreciable fixed assets. The owning organization is responsible for determining the useful life of the personal property asset except for aircraft, which is provided for in 4 FAM 736.2-1, paragraph c. The depreciation rate will reflect estimated salvage value, which for personal property is standardized at 10 percent except where noted in this subchapter (e.g., software, armored vehicles, and property held by contractors in high-risk areas). When property is transferred to the Department from another Federal agency, the useful life used by the transferring agency should be taken into consideration when determining the remaining useful life of the property. Salvage values for such transferred property are recorded at the lesser of:

(a) The amount designated by the transferring agency; or

(b) The amount that would be applicable if the Department had purchased the item;

(3) **Internal use software**: As a general rule, capitalized software property is amortized over a 3-to-5-year useful life as designated by the developing entity. While SFFAS Number 10 does not specify a specific amortization time period, Bureau of Resource Management (RM) policy limits the amortization period to five years or less. However, if the software owning organization provides a justification for a longer useful life, the Director of the Financial Policy Reporting and Analysis Directorate (RM/FPRA) will consider an amortization schedule consistent with the software's useful life. Amortization begins the first day of the first full month after the software receives Information Technology Change Control Board (IT CCB) or local Change Control Board (CCB) approval and an authorization to operate from the Department's Designated Approving Authority. Software does not have a salvage value. See 5 FAM 814, 5 FAM 619 and 5 FAM 864, paragraph d.

4 FAM 735 ACCOUNTING FOR INTERNAL USE SOFTWARE

(CT:FIN-384; 06-19-2007)

The Statement of Federal Financial Accounting Standard (SFFAS) Number 10 - Internal Use Software, identifies the accounting requirements for software designed for internal use. Essentially the standard requires software purchased or developed for internal needs to be treated as an asset in the Department's general ledger if it meets the definition and capitalization criteria identified in section 4 FAM 735 and in section 4 FAM 734.2, subparagraph a(4), respectively. The capitalized cost for the software is amortized in accordance with its expected useful life.

4 FAM 735.1 Requirements for Capitalizing Internal Use Software

(CT:FIN-384; 06-19-2007)

a. Not all software internally developed or contractor-developed software procurements need to be capitalized. To assess the criteria for capitalizing a software development project or procurement action, a plan must be prepared that identifies the following:

   (1) Functionality of the proposed software investment;

   (2) Estimated cost for the software portion; and

   (3) Estimated useful life upon delivery/acceptance of software.

b. A decision to capitalize internal use software requires some judgment, exercised in accordance with the guidance in 4 FAM 735. Investments in internal use software must be capitalized when the investment is projected to meet all three of the following requirements:

   (1) Create or significantly enhance existing Department functions or capabilities;

   (2) Meet or exceed the Department-determined cost threshold for the investment (see 4 FAM 734.2, subparagraph a(4), and 14 FAM 425.6-4, paragraph b); and

   (3) Have an estimated useful life of two years or more.

c. Projects to be capitalized must follow the instructions set forth in the Department's Capital Planning and Investment Control Program Guide and administered by the e-Gov Program Management Office.

d. Projects that do not create a new function or substantially enhance an existing capability are not capitalized. An example would be a minor software modification resulting form ongoing systems maintenance, which would be considered a modification to an existing function. The cost would not be capitalized even if the anticipated cost exceeds the capitalization threshold and the resulting change would have a useful life of more than two years.

4 FAM 735.2 Accounting Guidance Applies to Internal Use Software Only

(CT:FIN-384; 06-19-2007)

Since the Department does not, generally, develop software for external parties or other government entities, the accounting guidance in 4 FAM 730 does not cover software sales or licenses to third parties. Should a circumstance occur whereby Department-developed software is offered for sale or license to an external party, the accounting for a sale or license should be coordinated with the Office of the Deputy Chief Financial Officer.

4 FAM 735.3 Software Development and Procurement Options

(CT:FIN-384; 06-19-2007)

a. Software investments generally take one of the following forms:

   (1) In-house developed: Software developed by Department contractor and/or direct-hire employees. Coding is developed from scratch based on a concept design or plan;

   (2) Commercial off-the-shelf (COTS) procurements;

   (3) Government off-the-shelf (GOTS) procurements; or

   (4) Mixed COTS/GOTS procurements and in-house development.

(See 5 FAM 900 and 1000 for IT acquisition and planning requirements.)

b. For both internally developed and off-the-shelf software investments, the costs capitalized must include all the direct costs needed to create, install, configure, and test the software as well as any cost associated with initial user training, training materials, and user documentation prior to or at the point of final acceptance by Information Technology Change Control Board (IT CCB) or local Change Control Board (CCB) and an authorization to operate from the Department's Designated Approving Authority (see 4 FAM 735.5).

c. Direct costs would include contractor and Department personnel and initial training costs associated with creating or procuring, implementing, and testing the software. Hardware and software license costs are to be included if costs incurred to perform the work (e.g., special platform that will serve no other purpose) are not captured as an element of personal property (e.g., contractor-furnished equipment that is not purchased under object code 3100).

d. Indirect costs should also be identified and included in capitalized costs in accordance with 4 FAM 734.1. A project code should be used for all direct costs and indirect costs should be estimated during the period the software is in development.

e. Many software development projects require a mixture of software technologies (e.g., COTS/GOTS and in-house development) to achieve a desired functionality or capability. When this occurs, the cost of the project should be capitalized in accordance with 4 FAM 735 when the total estimated cost for the mixed software development effort is projected to exceed the capitalized threshold for software development (see 4 FAM 734.2, subparagraph a(4)).

4 FAM 735.4 Commercial off-the-Shelf/Government off-the-Shelf (COTS/GOTS) Licenses

(CT:FIN-384; 06-19-2007)

a. For commercial off-the-shelf/government off-the-shelf (COTS/GOTS) software purchased for a general purpose function, the initial license cost (if applicable) is capitalized as a software development cost as well as annual license costs that must be incurred as part of a COTS/GOTS configuration and testing process. However, annual license costs after the software has been configured and accepted by Information Technology Change Control Board (IT CCB) or local Change Control Board (CCB) approval are not capitalized and should be expensed in the period incurred.

b. Costs for follow-on licenses (e.g., corporate licenses for deployment purposes) should be treated in accordance with 4 FAM 734.2, subparagraph a(4), or treated as capital leases if the license agreement is consistent with the leasing criteria under 4 FAM 734.2, paragraph b. Site licenses needed to deploy software at additional locations should be capitalized as personal property if purchased in bulk or expensed if the site license cost does not exceed the capitalization threshold for personal property.

4 FAM 735.5 Capturing Software Costs

(CT:FIN-384; 06-19-2007)

a. The accumulation of costs to be included in capitalization may begin only after:

   (1) Management authorizes and commits to a computer software project and believes that it is more likely than not that the project will be completed;

   (2) The conceptual formulation, design and testing of possible software project alternatives have been completed; and

   (3) It is determined that the software will be used to perform the intended function with an estimated service life of two years or more.

b. The accumulation of capitalized software costs will terminate on the date the software is accepted by Information Technology Change Control Board (IT CCB) or local Change Control Board (CCB) approval is authorized to operate by the Department's Designated Approving Authority. Costs incurred after final acceptance testing has been successfully completed and costs to convert, purge, cleanse, or reconcile data should not be capitalized. In instances where a formal acceptance procedure is not performed by IT CCB or the local CCB and the Department's Designated Approving Authority, the software will be considered accepted as of the date the software is placed in service. Should a circumstance occur whereby software is prematurely placed in service without a formal procedure and additional costs must be incurred to meet an appropriate operating performance, the Bureau of Resource Management's Office of Financial Reporting and Analysis (RM/FPRA/FRA) must be consulted on the need to capitalize the additional cost.

4 FAM 735.6 Accounting Treatment for Impaired or Terminated Software Development

(CT:FIN-384; 06-19-2007)

a. A loss due to software impairment is recognized and measured when one of the following occurs:

   (1) The software is no longer able to perform the service intended and will be removed from service; or

   (2) A significant reduction in the capability, function, or use of the software occurs and it is unlikely the capability or use will be restored.

b. If impaired software remains in use, the impairment loss should be measured as the difference between the book value and either:

   (1) The cost to acquire software that would perform similar functions (that is, the remaining unimpaired functions); or

   (2) The portion of the book value attributed to the remaining functional elements of the software.

c. A loss is recognized when the software is judged impaired, and the book value of the asset should be reduced accordingly. If a software license or other element of the residual software has a net realizable value (NRV) that can be used in another functional area, the book value should be reduced to the NRV and amortized over any remaining useful life. If a book value of the remaining unimpaired functions cannot be determined at the point of impairment, any remaining book value should be amortized over the remaining useful life of the software or until the planned date to take the software out of service, whichever is shorter.

d. If management determines that it is no longer likely that software under development will be completed and placed in service, the software-in-development cost up to the termination date will be reduced to the expected NRV, if any. Any difference between the software in development cost and the NRV will be recognized as a loss in the year the software development was terminated.

4 FAM 736 U.S. GOVERNMENT-OWNED PROPERTY HELD BY CONTRACTORS OR HOST GOVERNMENTS

4 FAM 736.1 General Provisions

(CT:FIN-384; 06-19-2007)

a. Property for which the U.S. Government has title but is in the hands of contractors or host-country governments, such as in the case of bilateral agreements and other foreign assistance, is accounted for as assets of the Department and included in its financial reporting as general property. Much of the Department’s contractor-held property is either aviation assets or vehicles. However, contractor-held property can fall into any one of the personal property categories discussed in 4 FAM 733.1-3, paragraph b. Due to the nature of the aviation assets, certain unique provisions apply. These are contained in 4 FAM 736.2-1. There are also special provisions that apply to contractor-held property in high-risk areas as described in 4 FAM 736.3.

b. The same capitalization thresholds as apply to other personal property shall apply to these assets. Contractor-held property should be reported at the dollar cost to acquire or the dollar value/cost identified when furnished by the Department. Transferred property to the contractor from another Federal agency or non-U.S. government owner should be reflected at the cost basis of the property transferred. When no cost basis for the property is identified by the transferring entity, the value assigned to the property on the date of transfer should be used. The specific costs to be identified are described in 4 FAM 734. Property acquisition or transfer dates should be identified with the reported cost information.

c. Department contractors with U.S. Government-owned property that is acquired by or transferred to custody of the contractor and meets the capitalization thresholds must report property holdings quarterly to the contracting officer's representative (COR) with a copy to the contracting officer and the Bureau of Resource Management (RM). Except for the inventory submission in conjunction with the physical inventory described in paragraph d of this section, quarterly dispositions and transfers may be reported in lieu of a complete inventory once a baseline of the contractor-held property is established. The COR is responsible for obtaining the required property data similar to that obtained for Department-held property, including acquisition cost. The COR is also responsible for resolving with the contractor any discrepancies in the quarterly or annual reporting (e.g., unexplained variances).

d. When appropriate, a contracting officer may designate another individual to perform the function described paragraph c of this section. All designations must be in writing and approved by the responsible bureau executive director or equivalent management level.

e. Contractors are required to perform a physical inventory annually of the U.S. Government-owned property in their custody, consistent with contract terms, and to provide a written assurance by a senior official of the contractor as to the accuracy of the inventory information submitted to the Department. The property information and annual assurance are to be submitted in accordance with contract provisions or other instructions issued by the Office of the Procurement Executive (A/OPE) and the contracting office.

4 FAM 736.2 Bureau of International Narcotics and Law Enforcement Affairs (INL) Aviation Assets

4 FAM 736.2-1 Aircraft

(CT:FIN-384; 06-19-2007)

a. Aircraft property held by Bureau of International Narcotics and Law Enforcement Affairs (INL) contractors is classified as general property, plant and equipment (PP&E). Aircraft (i.e., fixed-wing or rotary aircraft) and aviation program component property is recorded at cost on the purchase/transfer-in date when the title passes or the date placed in service whichever comes first. The cost basis of the property must be determined by one of three measures, according to the following hierarchy:

(1) Acquisition (purchase) cost, if known, plus the cost of refurbishment necessary to allow the unit to be placed in service or used as a spare; or

(2) Net book value (NBV) on the books of the transferring agency if acquired from another Federal entity plus the cost of refurbishment necessary to allow the unit to be placed in service or used as a spare; or

(3) If no other cost information is available, the manufacturer-suggested book value for a refurbished piece of equipment that is operational and placed in service.

b. All fixed-wing and rotary aircraft must be capitalized regardless of value, type, and mission configuration.

c. Capitalized fixed-wing and rotary aircraft will have a useful life of 10 years for INL airwing and 5 years for nonairwing. Depreciation will be computed on a straight-line basis when 4 FAM 736.3 is not applicable. The depreciation rate will be based on a 10% salvage value.

4 FAM 736.2-2 Repairs and Improvement to Bureau of International Narcotics and Law Enforcement Affairs (INL) Aircraft

(CT:FIN-384; 06-19-2007)

a. Repairs to Bureau of International Narcotics and Law Enforcement Affairs (INL) aircraft and program property shall be expensed in the year performed when the repairs are routine and overhaul of the entire aircraft or program property is not required. Both the parts and the cost of the repair are expensed when the routine or normal repairs are required to keep the property operational.

b. Major/complete overhauls of fixed-wing and rotary aircraft require special accounting treatment when the property requires more than an engine or major component from the spare parts inventory. When an aircraft or other capitalized property is sent to a facility for a complete overhaul, substantial modification, and/or refurbishment, the accounting records will reflect a change to the status of the aircraft and all depreciation of the property will cease. A disposal will be recorded in accordance with INL information regarding the date the aircraft is taken out of service.

c. When the aircraft (with same tail number) is subsequently returned and placed in service, all overhaul and/or refurbishment costs to the aircraft, including the cost of shipping to and from the overhaul/maintenance facility, will be recorded as part of the basis for the property. Given the substantial nature of the work performed in the overhaul process, depreciation for the overhauled aircraft will be based on a new useful life and computed in the same manner as a new acquisition of similar property.

d. In the event of abnormal conditions not addressed by paragraphs b and c of this section, RM/GFS/F/AO/AA in consultation with the Financial Policy Reporting and Analysis Directory (RM/FPRA), will determine the specific accounting treatment to apply on a case-by-case basis.

4 FAM 736.3 Contractor-Held Property in High-Risk Areas

(CT:FIN-384; 06-19-2007)

a. For property held by contractors in high-risk areas where the property could be heavily damaged or completely destroyed, the deprecation convention may be accelerated and/or the useful life shortened to no more than 36 months to reflect operating conditions. Property in high-risk areas will have zero salvage value. The Bureau of Resource Management’s Deputy Chief Financial Officer (RM/DCFO) or designee is responsible for designating high-risk areas for purposes of this FAM provision and approving the depreciation convention and any other special treatment for property in these areas.

b. Upon a determination by the RM/DCFO that conditions in an area warrant a designation as high risk, acquisitions after the date of the determination will be at the accelerated rate, and existing property with more than 24 months of useful life remaining will be fully depreciated by the end of the next full fiscal year. When the RM/DCFO determines that conditions in the area are no longer high risk, all existing property will continue to depreciate at the accelerated rate without a salvage value, but new acquisitions will be handled in accordance with the requirements in for other personal property (see 4 FAM 734.3).

4 FAM 737 THROUGH 739 UNASSIGNED